IN THE

Supreme Court of the United States

OCTOBER TERM, 1942

No. 319

FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor, and CENTRAL TRUST COMPANY, Trustee for Fidelity Assurance Association,

Petitioners,

vs.

EDGAR B. SIMS, Auditor of the State of West Virginia, and Ex Officio Insurance Commissioner of the State of West Virginia; ROSS B. THOMAS and H. ISAIAH SMITH, West Virginia State Court Receivers; BANKING COMMISSION OF WISCONSIN; CHAS. R. FISCHER, Commissioner of Insurance and Permanent Receiver for debtor corporation in and for the State of Iowa; JOHN B. GONTRUM, Insurance Commissioner of the State of Maryland; DEWEY S. GODFREY, Missouri State Court Receiver; L. H. BROOKS, Trustee, FREDERIC LEAKE and A. L. GOLDBERG, JR., Trustee; and SECURITIES AND EXCHANGE COMMISSION,

Respondents.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fourth Circuit

REPLY BRIEF OF PETITIONERS

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JARRETT PRINTING COMPANY, CHARLESTON, W. VA.

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REPLY BRIEF OF PETITIONERS

FOREWORD

Three briefs have been filed on behalf of various respondents. One has been filed on behalf of the Banking

Commission of Wisconsin and the Commissioner of Insurance of Iowa, jointly, to which we shall refer as the "Wisconsin Brief". Another has been filed on behalf of Edgar B. Sims, State Auditor of West Virginia, and H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers, to which we shall refer as the "West Virginia Brief". A third has been filed on behalf of the Insurance Commissioner of Maryland, to which we shall refer as the "Maryland Brief". It had been expected that a Brief would be filed on behalf of L. H. Brooks, Trustee, et al., Tennessee creditors, but, although the time for filing respondents' briefs has long since passed, no such brief has yet been received. If such brief were filed, it would be referred to as the "Tennessee Brief". A brief purporting to be a "Joint Amici Curiae Brief" on behalf of the attorneys general of a number of states and some other counsel has been filed.

The appropriate state abbreviations, followed by numerals, will indicate page references to these state briefs. Otherwise, the terminology and references will be in general the same as those followed in the Brief of Petitioners.

SCOPE OF REPLY BRIEF

The number and volume of the several briefs of the respondents make impracticable, if not impossible, the preparation and printing of separate detailed reply briefs, or of a single brief replying in detail to the several briefs of the respondents within the time elapsing between the filing of the respondents' briefs and the day of argument. We shall present in this reply brief some of the fallacies common to the respondents' briefs and generally reply thereto, and, in addition, shall comment upon some of the more flagrant errors of the several briefs of the respondents.

ARGUMENT

The respondents take the position that nothing will constitute a reorganization of Fidelity except the complete rehabilitation of Fidelity as a going concern carrying on the same business that Fidelity carried on prior to December 31, 1940, in substantially the same manner; and, since it is obvious that there must be some readjustment of Fidelity's business, they argue that there is no alternative between such complete rehabilitation and immediate liquidation. Upon this fallacious premise the respondents then argue that, since nothing is to be done except immediately to liquidate and distribute the assets of Fidelity, the petition was not filed in good faith for the reason that under Sec. 146 (4) the state courts better subserve the interests of creditors than does the reorganization court under Chapter X.

We shall first demonstrate the fallacy of this false premise and then show that, even if the premise were sound, the conclusion would, nevertheless, be erroneous.

The Respondents' Contention that Reorganization Can Be Nothing Except Complete Rehabilitation of Fidelity as a Going Concern.

The respondents insist that there can be no reorganization of Fidelity other than complete rehabilitation (Wis., 98-99; W. Va., 46, 82; Md., 54). The respondents make this contention without reference to either statutory support from or judicial application of Chapter X. They (except in the Maryland brief and in that only as to the statute) make this contention without any effort to explain away the express provisions of Sec. 216 (10), or to differentiate or show the inapplicability of the many decisions of courts of competent jurisdiction holding otherwise. To reply to this contention of the respondents, other than to refer to Sec. 216 (10) and to the cases hold-

ing otherwise cited in the footnote to page 42 of Petitioners' Brief, would be mere repetition and would unduly extend this reply brief.

Petitioners Deny that They Have Conceded Impossibility of Rehabilitation

The petitioners emphatically deny that rehabilitation as a going concern is an impossibility or that they have at any time made any such concession. Unquestionably, complete rehabilitation is not a strong probability, principally for the reason that there are other likely methods of reorganization which would seem to be more available and which make it unnecessary that the petitioners rely upon complete rehabilitation.

Changes in interest rates and the extension of maturity dates with respect to the Fidelity contracts obviously would permit Fidelity to be rehabilitated.

As a matter of fact, Mr. Koontz, whose firm is now the attorneys for the West Virginia Receivers and speaks for the West Virginia State Auditor (836), and who for several years was a director of Fidelity and acted as an attorney for Fidelity, particularly in relation to financial matters, testified in the hearing of this case that during 1938, 1939, and 1940 he was of the opinion that Fidelity was a company which should be rehabilitated and which "*could be* rehabilitated." (1202-1204.)

Fred Risley, president of Fidelity, testified that Fidelity could operate under the Insurance Company Act of 1940 loading provision, and that the reserve requirement made it impossible for Fidelity to qualify. (866-867.)

The Contention of the Respondents that the Petitioners Rely Only on Slow Liquidation as a Plan of Reorganization.

The respondents argue from another false premise: that the petitioners rely solely upon a slow, orderly, and

unified liquidation as a means of reorganization and insist that such liquidation is not within the scope of reorganization.

In both of these contentions the respondents err. The petitioners do not rely solely upon any such liquidation. From the record it would seem that among the most likely methods of reorganization would be the organization of a new mutual company, the sale of Fidelity's assets to a stronger company under a contract which would provide for the continuance of Fidelity's business for the benefit of the creditors, the annuity contracts to be so modified as to interest rates and maturities as the circumstances might require, or the merger of the Fidelity business with the business of some other corporation, insurance or annuity, in either case the Fidelity contracts to be continued as annuity contracts or replaced by insurance contracts where the contract holder is physically insurable, coupled also with the right of the creditor to receive within a reasonable time the payment of the value of his claim in cash in the event he should not desire to accept either an annuity or an insurance contract. Any such reorganization would eliminate in large measure the heavy overhead of Fidelity which has proven to be so disastrous.

However, from the standpoint of passing judgment upon good faith in filing the petition, a well-ordered, unified liquidation is within the scope of reorganization (See cases, Petitioners' Brief, 50; S. E. C. Brief, 47 and 48), and the District Court was well within its proper powers in considering such possibilities when that Court concluded that the petition was filed in good faith even though the court may properly have felt that there would not likely be an occasion to resort to this particular plan of reorganization. The petitioners and the S. E. C. may

with perfect right rely upon this plan of reorganization, along with other more desirable plans, but, most certainly this possibility is not relied upon as the only available plan of reorganization.

When the respondents argue that a well-ordered, unified liquidation does not constitute reorganization and that liquidation, as distinguished from reorganization, is inevitable in this case (Wis., 113; Md., 58; W. Va., 82; 89), they again ignore the clear decisions of courts of competent jurisdiction because they know that they cannot escape the applicability of such decisions if they should undertake to discuss them.

Respondents' Contention that from the Factual Standpoint Liquidation Is Inevitable.

The respondents uniformly argue from an unestablished premise that, factually, speedy liquidation and distribution of the assets of Fidelity is inevitable. The Maryland Brief (Md., 46; 50) would belittle the testimony of qualified witnesses that Fidelity could and should be reorganized. This Honorable Court is again invited to look to the full testimony of said witnesses as it is referred to in Petitioners' Brief at pages 44-45, and then contrast that testimony with that of the witness Steussey (1005-1052), who was the only witness who testified that in his opinion Fidelity could not be reorganized. Steussey's opinion appears to have been based largely upon the fact that the Fidelity sales organization had been disbanded (1027-1028). Steussey was himself a former Fidelity salesman (1006) as well as a very versatile witness.

Not infrequently actions speak louder than words and so it is in this case. The state proceedings were originated by the West Virginia Auditor who with probable accuracy may be referred to as the principal respondent herein. Counsel for the West Virginia Receivers says

for reorganization

that he also speaks for the West Virginia Auditor (836), and, in the hearing of this cause, stated in open court:

> "Mr. Palmer: I had that intention with this witness to develop that. Might I also state that I think, as stated before on the record, that it is the opinion of myself as counsel that while a life insurance plan is feasible in the State Court, it is not feasible in the Federal Court because of my own personal view of the law that this Court cannot reorganize Fidelity into or keep it as an insurance company for the reason that I think this Court has no jurisdiction to give birth or to help grow an insurance company where it cannot bring it its demise or obsequies." (1076-1077).

The earlier statement, likewise made in open court in answer to a question by the Court, was:

> "The Court: Mr. Palmer, there is one thing the Court would like to get straightened out in its own mind as to the position you are taking in this suit here. As I understand, you represented the receivers in the state court proceeding, and Mr. Smith as one of the receivers says that his whole thought in the matter was to try to effect a reorganization, and I presume that you as his attorney in that matter were one with him in that thought. Now, you are appearing here and from your questions it seems that you are endeavoring to prove that there is no possibility of any reorganization. That appears inconsistent to the Court and I would like to know what the explanation of that is, Mr. Palmer.
>
> "Mr. Palmer: I think that is a fair question and I will be more than glad to state my position on the record, your Honor. If the Court please, I understand this: that under this table just introduced in evidence as Exhibit No. 28 there are 15 different states which required deposits and 20

states where the debtor was required to obtain a license, (fol. 637) and there were some seven to nine different contract funds and series in these various states, so taking each one for one it adds up to a total of 117 classes of creditors. Now, it is my opinion that it is impossible at this time to obtain the consent of two-thirds of each of these classes of creditors to any plan of reorganization that can be presented. In the second place, it is my opinion that no plan can be formulated which this Court will approve which will have the approval of that number of creditors. However, I do feel that there are a large number of contractholders who would prefer, as Mr. Smith and others have said, some form of company whereby periodic installment savings can be made; that they like the idea and are willing to continue it, and it is my personal belief, as counsel, and having talked to some others about it, that if a group as large as, say, $10,000,000 or 40% would approve of such a plan, or 50% that in state court proceedings they voluntarily agree to that, that then an insurance company could be formed by their voluntary agreement which could do that; that, however, the Federal Court's hands are bound by Chapter 10 proceedings and unless two-thirds agree, even though 40% or 50% or 60% would agree, the Court would have to reject the plan; and I (fols. 638-660) sincerely feel and I think that the state court receivers feel that in state court, particularly prior to the bringing of this suit, there was every possibility and likelihood of a very substantial part, a large enough part to make it worthwhile, of these contractholders agreeing to some plan among themselves for voluntarily keeping this going and not having at the very last a forced liquidation.

"The Court: Did you then, and do you now, consider that such a reorganization on the part of

any percentage of the contractholders is beneficial to them?

"Mr. Palmer: Yes, sir, I do.

"The Court: Then your only doubt, and your only question, is as to the possibility of getting a sufficient percentage to agree?

"Mr. Palmer: Yes, that is correct, your Honor." (486-487).

It will be recalled that the West Virginia proceeding was instituted for reorganization and the letter of the Judge of the Circuit Court of Kanawha County presented in the Appendix to the West Virginia Brief (W. Va., 128-130) shows beyond doubt that the Circuit Court of Kanawha County regarded the proceeding instituted by the West Virginia Auditor as one for reorganization.

In the Maryland Brief (Md., 62) it is stated that the Judge of the Circuit Court of Kanawha County was advised that such proceeding was for reorganization.

The president of Fidelity, who participated in the various conferences with the West Virginia Auditor, the Securities and Exchange Commission, and Fidelity's attorneys, states that the sole purpose of the West Virginia State proceeding was to hold the assets in statu quo while the company could arrive at some reorganization plan.

Though this particular testimony was referred to by record reference in Petitioners' Brief, we believe its significance in this connection warrants its reproduction here:

"Mr. Palmer: Isn't this true, Mr. Risley, that the company recognized that something must be done, and that they were not objecting to some sort of proceedings brought in order that the assets

might be held in statu quo while the company could arrive at some reorganization plan?

"A. That was the sole purpose.

"Q. And that that is why there was no objection on the company's part to Mr. Sims suit? Isn't that correct?

"A. That is correct, yes, sir.

"Q. The company knew that there had to be something done, otherwise there might be a run on the company by cash surrenders which would give those who got there first their money and those who came last would not get (fol. 2606) any?

"A. That is correct.

"Q. So that the company had, through its officials, after this letter of Mr. Sims as well as before, discussed with Mr. Sims the possibility or need of such a suit, and also had discussed the possibility or need of a federal court suit? Isn't that right?

"A. That is right.

"Q. And it was only after a thorough discussion and weighing of all matters that the company decided that it preferred, if it had a choice, the state court proceeding?

"A. After weighing the matter it was the unanimous opinion of the board of directors that the state court method would be the best.

"Q. And isn't it further true that not only the sentiment, or the expressed sentiment, of the board of directors was that that state court proceeding would lead to a reorganization of the company rather than a liquidation of it?

"A. Reorganization was the only thing that we were considering.

"(fol. 2607) Q. There was no thought of any kind, either by Mr. Sims, by the SEC or by the company, of a liquidation, but only a thought of some sort of reorganization? Isn't that true?

"A. Reorganization is the only word that I heard mentioned in any of those conferences." (895-896)

When, we may ask, did the West Virginia State Auditor and counsel for the West Virginia Receivers conclude that liquidation was inevitable? The letter of March 21, 1941, from the West Virginia Auditor to Mr. Koontz, Attorney for Fidelity (W. Va., 126-127), indicates that, had Fidelity determined to file a petition under Chapter X prior to the institution of the West Virginia State Court Proceeding by the Auditor, the West Virginia Auditor would have been satisfied.

We think there is little doubt but that, had Fidelity presented a petition under Chapter X prior to the institution of the West Virginia State Proceeding, not only would it have not been asserted by anyone that it was unreasonable to expect that a plan of reorganization could be effected, but that the superiority of the bankruptcy court over the several state courts for these purposes would never have been questioned, and it would have never been suggested that Fidelity was an insurance company, as the State Auditor in his answer in this proceeding originally admitted that Fidelity was not an insurance corporation and was a corporation eligible for bankruptcy (59).

It may be that these various admissions by the West Virginia Auditor and counsel for the State Receivers are not binding upon the other respondents. On the other hand, the record shows that all of the state proceedings

were, in reality, instigated by the West Virginia Auditor thinking that the other states would join in a program of holding the assets of Fidelity in statu quo pending a voluntary reorganization in the State Courts. The Wisconsin officials disagreed with the West Virginia State Court Receivers and proceeded to commence liquidation. It was then apparent to the directors of Fidelity that if there were to be any reorganization it would have to be under Chapter X, and the directors, with commendable foresight, proceeded to cause the petition to be filed.

The respondents would make much of the fact that Fidelity had not been financially strong for many years and that Mr. Koontz and Mr. Messick, on Fidelity's behalf, had made efforts to bring in new capital but had not been successful. It must be remembered that at no time prior to the filing of the petition under Chapter X had Fidelity sought any reorganization or recapitalization other than such as would preserve a corporate interest of value to the stockholders. In other words, Fidelity had not theretofore put its affairs in a position where the interests of creditors alone were to be considered. The Latta projected plans contemplated a voluntary reduction in the value of their contracts by the contract holders of about fifteen per cent (Exhibits 111, 112, pp. 1069 ff.; 1093; 1100; 1126), and Fidelity expected to rely upon salesmanship to put such a program over (1094). Under the standards of Chapter X such a reorganization would not have been fair or reasonable. That is probably the reason why Fidelity desired to go into the State Court rather than into the Bankruptcy Court (*Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106), but, when Fidelity's petition was filed in the reorganization court under Chapter X, Fidelity irretractably gave up any hope of preserving any value to the stockholders in the event it should prove, as would seem to be the case, that the assets of Fidelity were less than its debts (*Case* v. *Los Angeles Lumber Co., supra*).

The failure of Fidelity to enlist new capital under those circumstances is not surprising and does not refute the probability of reorganization upon a plan in which the interests of creditors only is to be considered. The earlier efforts made by Fidelity were not under reorganization statutes but were planned upon a basis purely voluntary.

The very nature of the Fidelity assets bespeaks probabilities of successful reorganization because of the facility by which new certificates or contracts might be issued according to the exact interests of the various creditors.

Good faith in the filing of the petition under Chapter X is a question of fact upon which the findings of the trial court should not be disturbed unless clearly erroneous (*Wayne United Gas Co.* v. *Owens Illinois*, 91 F. (2d) 827, 831; *Seaboard Terminals* v. *Western Maryland*, C. C. A. 4, 108 F. (2d) 911.)

The Respondents' Contentions that the Assets Deposited by Fidelity with the Various States Are Not Property of Fidelity, that the Chaper X Proceeding and the Injunction Issuing Therefrom Constitute a Suit Against the States Contrary to the Eleventh Amendment to the Federal Constitution, and Constitute an Interference with the Police Powers of the States Contrary to the Tenth Amendment to the Federal Constitution.

The respondents argue that inasmuch as Fidelity is insolvent, its assets heretofore deposited with the several states are no longer property of Fidelity, and for that reason cannot be reached in this proceeding, that even if such deposits are property of Fidelity this proceeding constitutes a suit against the sovereign states contrary to the Eleventh Amendment, and that to interfere in this proceeding in any way with such state deposits would

involve federal action contrary to the Tenth Amendment to the Federal Constitution as an interference with the exercise of the police powers reserved to the states.

These arguments are presented by the respondents upon two theories. One theory is, that, since these deposits cannot be reached by the Chapter X proceeding, the reorganization court cannot control sufficient assets of Fidelity to make reorganization possible. The other theory is, that, since the bankruptcy court cannot deal in any way with such deposited assets, either by preserving their status by injunction or obtaining their possession by turn-over order, the petition has not been filed in good faith, for the reason that the prior court proceedings, in which the jurisdiction of the state courts is not questioned by the respondents, will better subserve the interests of creditors.

Deposits Are Property of Fidelity

Whatever may be the verbiage of the various state statutes requiring the deposits, the deposits are made for the benefit of the contract holders, the Fidelity creditors, and the states have no financial interest whatsoever in the deposits. Even the Maryland brief, which is based entirely upon the argument that the Chapter X proceedings cannot reach the state deposits, concedes that the states have no pecuniary interest in such deposits. (Md. 15.)

If for purposes of reorganization, pledged or mortgaged assets were regarded as assets of the debtor only when the value of the assets exceeded the amount of the debts, there would be very little subject-matter upon which Chapter X might operate.

The respondents apparently are unable to cite any authorities which sustain their argument in this respect.

In the Maryland brief, the cases *In re Prudence Co., Inc.*, 82 F. (2d) 755; *Warder* v. *Brady*, 115 F. (2d) 89; and

Seaboard Terminals v. *Western Maryland Railway*, 108 F. (2d) 911, are cited in support of the contention that the property is not that of the debtor unless an equity remain. None of these cases sustain such position. In the *Prudence* case, the property involved had previously been transferred by the Prudence Company to another company. In *Warder* vs. *Brady*, certain payments into a sinking fund had become the property of the beneficiaries of the sinking fund. Pledged or deposited property was not involved. In the *Seaboard Terminals* case, title, not only legal title but beneficial ownership in the property in question, had been conveyed to the Maryland Terminals Corporation. Seaboard Terminals had only a lease thereon which had been forfeited, and the Seaboard Terminals failed in its effort to establish that the conveyance to the Maryland Terminals Corporation was a mere mortgage in the form of a conveyance, rather than an outright conveyance.

On the other hand, there are many cases in which securities of less value than the debt secured are dealt with by the reorganization courts, and the case *In re Central Funding Corporation*, 75 F. (2d) 256, expressly holds that insolvency does not destroy the petitioner's interests in assets for purposes of reorganization. In that case it is observed:

> "It makes no difference whether the debtor has an equity of any value or not. * * * To restrict the Act to reorganizations where the debtor has an equity would be to deprive the section of much, if not most, of its usefulness."

Injunction Order Is Not Suit Against State

A suit is not a suit against a state contrary to the Eleventh Amendment to the Federal Constitution, unless some relief is sought against the state as such, or the control of political action is sought whether the de-

fendant in name be a state or a state officer. *Regan* v. *Farmers Loan & Trust Company*, 154 U. S. 362,

The respondents concede that the states do not have any pecuniary interest in these state deposits. So far as we have been able to find, the decisions of the courts uniformly hold that such deposits are subject to court orders.

In the case of *Hobbs, Commissioner of Insurance of Kansas*, vs. *Occidental Life Insurance Co.*, 87 F. (2d) 380, the insurance commissioner was required to deliver the deposited securities to the Occidental Life Insurance Company, which had reinsured the liabilities of the Federal Reserve Life Insurance Company, which had made the deposit, although Hobbs insisted that such suit was against the state. See also *Kansas* vs. *Occidental Life Insurance Company*, 95 F. (2d) 935 (certiorari denied, 305 U. S. 603).

In the case *In re Bajardi*, 8 F. (2d) 551, relied upon in the West Virginia brief (W. Va. 49) it was held that the Federal Court was competent to require the New York superintendent of banking to turn over to the trustee in bankruptcy securities deposited with the superintendent of banking pursuant to statute.

In *Morrill* v. *American Reserve Bond Co.*, 151 F. 305, the treasurer of Missouri was required to turn over to a receiver appointed by the Federal Court securities deposited with him pursuant to a Missouri statute.

In *U. S.* vs. *Knott*, 298 U. S. 544, it was held that the deposit of securities by a surety company with the treasurer of Florida, pursuant to a Florida statute, for the benefit of Florida creditors did not divest the surety company of its title. See also *Porter* vs. *Beha*, 12 F. (2d) 513; *Hayne* vs. *Metropolitan Trust Company*, 67 Minn. 245, 69 N. W. 916; *Prewitt, Insurance Commissioner* vs. *Illinois Life Insurance Co.*, 123 Ky. 36, 93 S. W. 633.

The respondents rely principally upon the cases of *Lankford* vs. *Platte Iron Works Co.*, 235 U. S. 461, and *Farish* v. *State Banking Board*, 235 U. S. 498. These cases have no application whatever to the case at bar. The funds there involved were funds collected by the state for the purpose of carrying on the governmental function of insuring bank deposits. The funds there involved were, in fact, asse s of a governmental agency, not unlike state workmen's compensation or state unemployment compensation funds, and the state court in discussing this fund had said that it was "as much a fund of the state as the common school fund."

That the other cases relied upon in the Maryland brief on this point involved governmental funds or governmental property is too clear from a consideration of those cases to merit detailed distinguishment herein.

In the West Virginia brief, the case of *Rollo, Assignee*, v. *Andes Insurance Company*, 23 Gratt. (Va.) 509, is relied upon. That case involved an attempt to garnishee funds in the hands of the state treasurer. In Virginia and West Virginia a garnishment procedure seeks, and if prosecuted successfully, results in, a judgment against the garnishee. This was, of course, the equivalent of a suit against the Commonwealth of Virginia. In the West Virginia brief, *State ex rel Stevenson* v. *Stephens*, 136 Mo. 537, 37 S. W. 506, appears also to be relied upon. As a matter of fact, the funds there involved, deposited with the state trasurer, were held not to be state funds, and the treasurer of the State of Missouri was required by mandamus to pay the money out to the holder of a mortgage lien note on real estate which secured a $100,000 note deposited by an investment company with the state treasurer pursuant to state law requiring such deposits for the benefit of investors as a condition to the right of such company to do business in the state, without the necessity

of complying with the state laws relating to the disbursement of state moneys.

The case of *Blake* v. *McClung*, 172 U. S. 239, also relied upon by the West Virginia brief, simply involved the constitutionality of a Tennessee statute which provided that the assets of a corporation admitted to do business in the State of Tennessee should be held for the payment of resident Tennessee creditors in preference to crditors residing in other states. This statute was held unconstitutional, insofar as natural persons were concerned, because it violated the privileges and immunities clause of the constitution. It was collaterally observed in the opinion that states may require insurance companies to make deposits on the security of claims of resident creditors.

We are certain that the Court is sufficiently familiar with the case of *Ex parte Ayers*, 123 U. S. 443, and its inapplicability to the case at bar to make any comment thereon here unnecessary.

The case of *Mitchell* vs. *Lay*, 48 F. (2d) 79, is also relied upon in the West Virginia brief. In reading this case petitioners' counsel had appreciable difficulty in identifying it with the case discussed thereunder in the West Virginia brief. In the West Virginia brief (W.Va., 68) it is said that a Federal Court proceeding was instituted in California ancillary to a Texas proceeding, and that in the California District Court the insurance commissioner of California was enjoined from interfering with "the Federal Court Trustee's possession of the Debtor's deposited assets." There was no Federal Court Trustee, and the case did not involve any bankruptcy proceeding. The California Federal Court proceeding was a diversity of citizenship proceeding actually instituted prior to the institution of the suit in Texas, to which it is said in the West Virginia brief

that the action was ancillary. The plaintiff was a mere claimant against the insurance company, and had a special fund to which she had the right to look for reimbursement, but sought to have administered in the Federal Court in California all of the assets of the insurance company. The real reason for the dismissal was that the plaintiff had no standing to bring the suit in the first instance.

Argument Under the Tenth Amendment

We believe that the cases hereinbefore discussed, such as *Hobbs* v. *Occidental Life Insurance Company* and, *In re Bajardi*, in which moneys deposited with state officials have by the orders of Federal Courts been required to be turned over to the persons entitled thereto, sufficiently answer the contention that such deposits with state officials cannot be reached, even by the processes of courts of bankruptcy, without invading the reserved police powers of the states contrary to the provisions of the Tenth Amendment to the Federal Constitution.

Much of the argument in the Maryland brief on this point relates to the so-called turn-over order entered by the District Court. The District Court amended *nunc pro tunc* the turn-over order and eliminated therefrom the turn-over requirements, but provided by injunction for the freezing or holding in statu quo of the state deposits.

In the Maryland brief, it is very frankly admitted that if the Maryland argument is sound, then the provisions of 67(f) of the Bankruptcy Act, as added by Section 29(b) of the Investment Company Act of 1940, would be unconstitutional.

Such impotency of the courts of bankruptcy, exercising a Federal power expressly conferred by the Federal Constitution, would indeed be a vast departure from all concepts heretofore entertained and judicially recognized with respect to the supremacy of the constitutional

powers of the national government generally, and particularly as to bankruptcy. (See *International Shoe Company* vs. *Pinkus*, 278 U. S. 261; *Continental Illinois National Bank* v. *Chicago R. I. & P. R. Co.*, 294 U. S. 648; *In re Park Beach Hotel Corp.*, 96 F. (2d) 886 (Cert. Den., 305 U. S. 638); *In re Merced Irrig. Dist.*, 25 F. Supp. 981, 114 F. (2d) 654 (Cert. Den., 311 U. S. 718).)

As we have observed above, we need not consider whether the turn-over order was pre-maturely entered or not. The cases above referred to clearly sustain the power of the reorganization court to issue such turn-over orders when appropriate to the exercise of the court's powers in bankruptcy, but at this time we are concerned only with the injunction order freezing the state deposits. In the Maryland brief, it is conceded that under the case of *Continental Illinois National Bank* vs. *Chicago R. I. & R. R. Co.*, 294 U. S. 648, it is appropriate that the bankruptcy court preserve the debtor's assets by injunction in order to afford an opportunity for reorganization. In the Maryland brief, it is also conceded that the *Central Funding Corp.* case (75 F. (2d) 256), sustains a turn-over order entered against a state official when a plan of reorganization has resulted in the accomplishment of the purposes for which the deposit was provided.

In the case at bar, when reorganization is effected, certainly it will not be contended by the respondents that the reorganization court might not properly enter an order directing the proper disposition of such state deposits.

So far as the present status of this case is concerned, the case of *Fischer* vs. *American Life Insurance Company*, 314 U. S. 549, relied upon in the West Virginia brief, clearly holds that rights in the *res* of the suit may be adjudicated and determined even though the possession of the *res* is in another court and is not disturbed. Thus the Maryland brief concedes the power of the District Court

to preserve the assets to afford an opportunity for reorganization and to direct the disposition of the assets upon reorganization; even though, for purposes of argument, it might be conceded that the possession of such deposits could not be disturbed prior to reorganization. Such a concession for purposes of argument would, however, be contrary to the established law.

Unquestionably, the District Court in exercising its jurisdiction under Chapter X has jurisdiction over all of the assets of Fidelity, and over all the creditors of Fidelity. When the District Court shall have adjudicated the rights of the creditors, certainly the purposes of the state deposits will have been accomplished, and no state would presume to retain such deposits after the purposes thereof had been accomplished. In the reorganization court, the dissenting creditors will be bound provided two-thirds of the creditors approve the plan of reorganization.

Statutory Receivership Cases Not Applicable

The respondents rely upon the case of *Pennsylvania* vs. *Williams*, 294 U. S. 176, and some other cases of the same general import, including the case of *Picklesimer* vs. *Morris*, 101 W. Va. 127, 132 S. E. 372. In *Pennsylvania* vs. *Williams* it was held that the District Court should relinquish jurisdiction of a suit based upon diversity of citizenship in favor of a statutory state receivership. In *Picklesimer* vs. *Morris*, the Supreme Court of Appeals of West Virginia held that the West Virginia courts would not supersede a statutory receivership for the administration of an insolvent bank. Both decisions, of course, were predicated upon the sufficiency and the adequacy of the statutory receiverships. The principle of judicial relinquishment in favor of statutory receivership proceedings is not involved in this case. We have no

statutory receivership in this case. In the West Virginia brief (W. Va., 95), it is said:

> "(12) It is true that the several States not only threaten but intend to distribute the assets held in those States, but it is not true that this is to be done without judicial proceedings. On the contrary, liquidation and distribution by the States will be made only in the State Courts thereof. * * *"

In the other briefs, it appears that the jurisdiction of the courts has been invoked with respect to all of the state deposits represented by any of the respondents.

The Auditor of the State of West Virginia, by way of illustration, has absolutely no powers of statutory receivership or liquidation. The auditor has no authority to disburse one cent of the deposits, or to accept a single proof of claim. All that the Auditor of West Virginia can do is to cause a suit in equity to be instituted in the Circuit Court of Kanawha County, West Virginia, pursuant to the provisions of Section 45 of Article 2 of Chapter 33 of the Code of West Virginia (Petitioners' Brief, Appendix 69). There is nothing to indicate that the state auditor has the exclusive right to invoke the jurisdiction of the courts for the purpose of administering such deposits. Such simple provisions are not ordinarily held to be exclusive of the right of other interested parties to institute and maintain such suits. (See *State ex rel. Hutchinson* (S. C.), 189 S. E. 475.)

If the principle of judicial relinquishment to statutory receiverships were involved, then clearly such statutory receiverships would not be "a prior proceeding * * * pending in any court" within the meaning of Section 146(4) of Chapter X.

It is obvious that the case of *Picklesimer* vs. *Morris*, supra, has no application here. The West Virginia stat-

utes provide for statutory receivership and liquidation of insolvent banks. (West Virginia Code, Chapter 31, Article 8, Section 32.) There is no such statutory provision with respect to corporations under the jurisdiction of the West Virginia State Auditor.

Respondents' Contention that Only State Courts Can Determine Questions of Law Involved.

In each of the respondents' briefs (Md., 68; Wis., 147; W. Va., 70) the respondents argue that the determination of the rights and interests of the creditors of Fidelity will necessitate the determination of many questions of state law, particularly the construction of the statutes requiring the deposits.

We would not suggest that as this cause proceeds some questions of state law, even some questions of state statutory law, may not have to be decided. Quite obviously one of the first questions to be decided will be the measure of the individual contract holder's participation in whatever assets he may be entitled to share, that is to say, whether upon the cash surrender value, the reserve value or the total amount of money paid in, including the rights of those who are in default to take advantage of the redating provisions. This is a question of the construction of the various contracts rather than of the construction of state statutes. Since the contracts were issued from Wheeling, West Virginia, upon applications from the purchasers therefor solicited elsewhere, and it was provided that payment should be made at the Home Office at Wheeling, West Virginia, it would seem that the law of West Virginia would be applicable (*John Hancock Mut. Life Ins. Co.* v. *Yates*, 299 U. S. 178), if in a Chapter X proceeding it should become material to apply the special law of any state.

Whether or not the deposits in the several states were of assets free of any prior obligations, trust or otherwise,

or whether any part of any state deposit is of assets which the particular state might not lawfully hold for the benefit of the creditors resident in the particular state (*Porter* v. *Beka*, 12 F. (2d) 513), is not a question of statutory construction. When these questions are determined, it is likely that the participation of the various creditors entitled thereto in a particular state deposit will be relatively a simple matter and one not likely requiring any technical interpretation of the state depository laws.

Be that as it may, we do not understand that the rule of *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, provides any iron clad rule of law applicable in bankruptcy proceedings.

In the case of *Prudence Realization Corp.* v. *Geist*, 1941, 316 U. S. 89, 95 it is observed:

> "Nothing decided in *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, supra, requires a court of bankruptcy to apply such a local rule governing the liquidation of insolvent estates. The bankruptcy act prescribes its own criteria for distribution to creditors. In the interpretation and application of federal statutes, federal not local law applies. (Cases cited.) The court of bankruptcy is a court of equity to which the judicial administration of the bankrupt's estate is committed, *Securities & Exchange Commission* v. *U. S. Realty & Improvement*, 310 U. S. 434, 455-457, and it is for that court—not without appropriate regard for rights acquired under rules of state law—to define and apply federal law in determining the extent to which the inequitable conduct of a claimant in acquiring or asserting his claim in bankruptcy requires its subordination to other claims which, in other respects, are of the same class."

In the case of *D'Oench, Duhme & Co.* v. *Federal Deposit Ins. Corp.*, 1941, 315 U. S. 447, in considering the question whether the Federal Deposit Insurance Corporation authorized to sue or be sued in any court of law or equity, state or federal, could recover on a renewal note acquired by it as a part of the collateral securing a loan to a bank insured by it, the receipts for the originals of which contained a provision that they would not be called for payment, of which provision the Federal Deposit Insurance Corporation had no notice, it was concluded that a federal question was presented and that a federal court was not bound to follow state law in deciding such question. In the opinion of the court referring to the principle of *Erie R. Co.* v. *Tompkins, supra*, it was observed:

> "We held in the latter decision (*Klaxon Co.* v. *Stentor Electric Co.*, 313 U. S. 487) that a failure of a federal court in a diversity of citizenship case to follow the forum's conflict of laws rules 'would do violence to the principles of uniformity within a state' upon which *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 was based. The jurisdiction of the District Court in this case, however, is not based on diversity of citizenship. Respondent, a federal corporation, brings this suit under an Act of Congress authorizing it to sue or be sued 'in any court of law or equity, state or federal.' • • • Whether the rule of the Klaxon Co. Case applies where federal jurisdiction is not based on diversity of citizenship, we need not decide. For we are of the view that the liability of petitioner on the note involves decision of a federal not a state question under the rule of Deitrick v. Greaney, 309 U. S. 190."

In a concurring opinion, Mr. Justice Jackson raises the question whether the doctrine of *Erie R. Co.* v. *Tompkins* extends beyond diversity cases.

In the case of *Sola Electric Co.* v. *Jefferson Electric Co.*, No. 45, 1942 Term, 87 L. ed. Adv. 150, it is held:

> "It is familiar doctrine that the prohibition of a federal statute may not be set at naught, or its benefits denied, by state statutes or state common law rules. In such a case our decision is not controlled by Erie R. Co. v. Tompkins, 304 U. S. 64, 82 L. ed. 1188, 58 S. Ct. 817, 114 A. L. R. 1487. There we followed state law because it was the law to be applied in the federal courts. But the doctrine of that case is inapplicable to those areas of judicial decision within which the policy of the law is so dominated by the sweep of federal statutes that legal relations which they affect must be deemed governed by federal law having its source in those statutes, rather than by local law. Royal Indm. Co. v. United States, 313 U. S. 289, 296, 85 L. ed. 1361, 1366, 61 S. Ct. 995; Prudence Realization Corp. v. Geist, 316 U. S. 89, 95, 86 L. ed. 1293, 1928, 62 S. Ct. 978, 48 Am. Bankr. Rep. (N. S.) 695; Jackson County v. United States, 308 U. S. 343, 349, 350, 84 L. ed. 313, 316, 317, 60 S. Ct. 285; cf O'Brien v. Western U. Teleg. Co. (C. C. A. 1st) 113 F. (2d) 539, 541."

In this case we are concerned with both substantive federal law and federal procedure, the subject of bankruptcy, particularly the reorganization feature thereof, comparable to which there is no state law, and in the procedural aspects of which no state counterparts are here available. Reorganization and the ordinary bankruptcy must inevitably be closely associated. Proceedings in state courts frequently precipitate bankruptcies. If the necessity of sometimes considering state laws may deprive or weaken federal jurisdiction in reorganization, or the mere fact that some state law, common or statutory, must be ascertained and declared by the bankruptcy court means that the state courts may better subserve the in-

terest of creditors than the bankruptcy courts, then the salutory purposes designed by the reorganization statute must inevitably be seriously restricted.

If questions of state law are presented, and in view of the foregoing cases it would seem that the law of bankruptcy is not state law, we readily appreciate the desirability of having a definite determination of such state law by the state courts. However, it has ever been necessary that the federal courts in exercising their proper jurisdiction at times ascertain and declare state law, both common and statutory. (See *Thompson* v. *Consolidated Gas Utilities Corp.*, 300 U. S. 55, 74; *Railroad Commission* v. *Los Angeles R. Corp.*, 280 U. S. 145, 152; *Concordia Ins. Co.* v. *School Dist.*, 282 U. S. 545, 553; *Portneuf-Marsh Valley Canal Co.* v. *Brown*, 274 U. S. 630; *Edward Hines Yellow Pine Trustees* v. *Martin*, 268 U. S. 458, 463.)

For the most part, the cases relied on in the respondents' briefs in which the federal courts declined to interpret and apply state law related to criminal statutes or ordinances of the states, questions of state taxation, or satutes relating to the official duties of state officials. For instance, the cases of *Beal* v. *Missouri P. R. Corp.*, 312 U. S. 45, and *Watson* v. *Buck*, 313 U. S. 387, (Md., 71) involved criminal laws of the states. *Chicago* v. *Fieldcrest Dairies, Inc.*, 316 U. S. 168, involved a municipal milk ordinance. *Texas* v. *Donoghue*, (302 U. S. 284) merely held that the Bankruptcy Court improperly denied the petition of the State of Texas to bring an action in the State Court against the debtor for the forfeiture of certain oil which the debtor had produced in violation of the conservation laws of the State of Texas. The decision of the Court pointed out that possession or control of the oil by the state court was not essential to its jurisdicion to entertain the suit proposed to be brought. The Texas

statute was considered to be penal in nature. Mr. Justice Cardozo, with whom the present Chief Justice joined, dissented upon the ground that the Federal Court was not called upon to lend its aid to the enforcement of the penal laws of the state.

In the cases of *Glenn* v. *Field Packing Company*, 290 U. S. 177, and *Lee* v. *Bickell*, 292 U. S. 415, referred to in the West Virginia Brief at page 71, the state questions presented were determined by the judgments of the federal courts and were merely held open to permit modification if at some later time the state court of final jurisdiction should decide otherwise. *Guaranty Trust Company* v. *Blodgett*, 287 U. S. 509, and *Hartford Accident & Indemnity Co.* v. *Nelson Mfg. Co.*, 291 U. S. 352, referred to in the West Virginia Brief on pages 70 and 71, respectively, merely announced the rule that federal courts are bound by the interpretation of state statute or constitutional provisions previously made by the state courts. The case of *Knights of Pythias* v. *Miles*, 255 U. S. 559, referred to on page 70 of the West Virginia Brief, we have been unable to find. We find in that book and at that page the case of *Knights of Pythias* v. *Overton*, which is a mere memorandum decision embodying no discussion of legal principles.

The West Virginia Brief (W. Va., 74) refers to *Toucey* v. *N. Y. Life Ins. Co.*, 1941, 314 U. S. 118. This case involved the application of section 265 of the Judicial Code inhibiting injunctions from federal courts to state courts. It is most significant to observe, however, that the inhibition of said section 265 of the Judicial Code does not apply to injunctions arising out of bankruptcy.

The case of *R. R. Commission* v. *Pullman Co.*, 312 U. S. 496, is referred to in each of respondents' briefs. This case involved the authority of the Railroad Commission

of Texas to issue a certain regulation. It was contended that such regulation, if valid under state law, would deny certain persons the equal protection of the laws. The authority of the Railroad Commission to issue any such order was questioned and had not been determined by the state courts. The federal court properly declined to pass upon the federal question prior to the consideration of the state question by the state courts for the reason that should the court of last resort of Texas decide that the Railroad Commission had no authority to make such regulation, then no federal question would be presented.

The case of *Thompson* v. *Magnolia Co.*, 309 U. S. 478, likewise is referred to in the Maryland and Wisconsin briefs. The question involved was one of Illinois Real Estate Law, whether a certain railroad right of way was an easement or fee interest carrying ownership of oil and gas. This Court concluded that the railroad's possession of the right of way afforded the basis for the exercise of the summary jurisdiction of the Bankruptcy Court to protect and control the estate and determine title, but that the case was of such a nature that it would be better for the Bankruptcy Court to consent to the submission of the question to the state courts for determination and to direct the Trustee to seek such adjudication in the state courts. Questions of real estate law are inherently questions of local law. Should any such questions arise in this proceeding, the precedent of *Thompson* v. *Magnolia Co.*, might be followed and the decisions of the state courts be sought by the direction of the reorganization court. Certainly that is a more practical disposition of such a problem than would be the refusal of the federal court to exercise its essential federal jurisdiction in bankruptcy merely because some questions of state law might arise. It would not be logical or reasonable to say that the state courts would better subserve the interests of creditors in reorganization merely because the State Courts could de-

cide such questions of state law as might possibly arise, when the State Courts have no jurisdiction to enforce the substantive bankruptcy laws, and in this case have no state reorganization statutes which would leave the proceedings in the state court in the status of equity receiverships, the flagrant inadequacy of which necessitated the enactment of Chapter X, and deny the creditors the salutory provisions of the federal law of corporate reorganization, Chapter X.

The foregoing observations, it is believed, make unnecessary any consideration of section 3 of the Wisconsin brief entitled "The Public Interest" (Wis., 148). Counsel know of no principle of law or practice which suggests that there is any public interest which requires a court of bankruptcy either to decline to take jurisdiction, or to yield jurisdiction taken merely because the assets of the bankrupt estate may at the time be or may previously have been involved in state litigation.

Segregation of Deposits by Contract Series

In the Maryland brief (Md., 9) it is said that the statement in the briefs of the petitioners and the Securities & Exchange Commission that Fidelity kept accurate and separate accounts for the reserve funds of each series of contracts issued by it, and that the books indicated what securities were purchased with the reserve funds of each series is misleading. In the Wisconsin brief (Wis., 27) it is said:

> "* * * no attempt was made to designate what particular funds the securities came from in forwarding the securities to the various states, nor did the states themselves make any such allocation."

The record sustains the statements in petitioners' and the Securities & Exchange Commission briefs, and refutes the statements in the respondents' briefs.

C. E. Smith testified that ever since the first deposit was made to the series B and to the series D, the securities deposited in West Virginia were even filed in separate chests (601-602).

Since approximately 1933 every deposit with or withdrawal from the State of West Virginia was accompanied by a schedule showing the name and description of the security, the par value, the interest rate, the date of maturity, the market value and the fund to which it belonged (599).

C. E. Smith also testified that:

> "Actually the securities were earmarked on our records, that is, for a particular fund, irrespective of the place of deposit." (611.)

Smith also testified that if Fidelity had purchased a bond ten years ago from the funds of class A Contract Fund, the serial number of the bond and the amount could be ascertained (617).

The West Virginia Auditor, Mr. Sims, required Fidelity to put into the series B contracts a provision that moneys received by the company from the contract holders of that contract would be held by the company separate and apart from all other funds (660).

The annual audits of Fidelity were sent to the officials of the several states in which Fidelity did business. (643; 756-757). F. J. McNulty testified: "On our annual audit report the segregation of funds was shown (761). C. E. Smith testified that the books of Fidelity were always open for inspection by the officials of the states in which Fidelity was selling contracts, and that from time to time representatives of those states came to Wheeling and made examinations of such records (616).

The testimony of J. H. Schellhase shows that the books of the company contained a complete record of the moneys received by the company from each contract fund, and a record of all securities purchased by the company from the moneys of each contract fund, and that each security was earmarked on the records (581-582). Exhibits 50 to 55 show compilations from the records of Fidelity with respect to the deposits in Illinois, Maryland, Missouri, Ohio, Tennessee and Wisconsin, and particularly the contract funds to which the securities deposited in each of these states belonged.

Exhibit 64-C (650), a letter from the Banking Commission of Wisconsin, shows clearly that the Wisconsin authorities knew and understood that the securities belonged to particular funds. In the letter it is stated:

> "It was our understanding, in the letter received from the Home Office, that this matter of adjustment of various trust accounts would have been completed prior to this date."

When, during the hearing of this case in the District Court, counsel for Wisconsin objected to the use of the term "trust funds" and was confronted with a telegram from the Banking Commission of Wisconsin, he recognized that the term "trust funds" was correctly used (653-654).

The witness H. F. Young testified that the state examiners and officials evidenced a knowledge that there were such trust funds as A, B, C, D, etc., and that the respective state officials, when they accepted the securities, knew that they were coming from specific trust funds (653-655).

Other testimony relating to these matters will be found in the record at pages 331-332, 581-582, 584, 593, 600, 606-609, 628, 633-635, 643 and in Exhibits 59 to 67, inclusive.

Respondents' Contention that Fidelity Officers Responsible for Institution of Chapter X Proceeding Seeking Some Benefit.

In the Wisconsin Brief (Wis., 116) and in the West Virginia Brief (W. Va., 28, 29, 33), it is insisted that the petition shows that Fidelity was seeking to carve an equity for itself out of the assets which belong wholly to the contract holders; and apparently base their contention upon the statement in the petition that it is necessary that the rights of the contract holders be modified to an extent so as to enable the debtor to meet "its reserve requirements" and be able to comply with the Investment Company Act of 1940. Respondents interpret this representation as manifesting the intent of the debtor that the contracts be modified so as to permit Fidelity to have the $50,000 clear capital. The phrase "reserve requirements" might just as well, and probably did, refer to the reserve requirements of the Fidelity contracts. But, be that as it may, when Fidelity filed the petition, it submitted to the reorganization court and could not retract therefrom even if it later desired to do so (*Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106). Certainly, even had Fidelity hoped to effect a reorganization which would enable it to have the requisite clear capital, such ambition would not invalidate the petition and, in view of the ruling of *Case* v. *Los Angeles Lumber Co.*, *supra*, would not be approved by the court.

Additional Comment upon the Respondents' Briefs, Severally

The West Virginia Brief

On page 10 the West Virginia Brief refers to contract holders from West Virginia, Tennessee, Iowa, Michigan, and Ohio appearing in the District Court and ob-

jecting to the Chapter X proceeding. This reference purports to be supported by pages 287-288 of the record. These pages merely list the appearances, and the Tennessee creditors there named are the only creditors who yet participate in this cause. After investigation, the Ohio creditors reversed their position and supported the petition (832-833). The Wheeling, West Virginia, mass meeting has resulted in no active opposition to the petition (W. Va., 31).

The statement on page 27 of the West Virginia Brief that there is positive evidence that there can and will be no new capital is not correct. There is only evidence that thus far no offer of new capital has been procured.

The West Virginia Brief would argue that the decision in the *Marine Harbor* case is practically controlling upon the case at bar and would seek to draw a series of analogies between the two cases. In the *Marine Harbor* case the debtor had made previous efforts but the previous efforts there were under a state reorganization statute. Fidelity's previous efforts were purely voluntary and without the aid of a reorganization statute. It is said that in both instances state legislation was specially enacted to deal with the particular circumstances. There is no such special legislation in West Virginia and, if there is any applicable special legislation in any other state, it has not yet been brought to the attention of this Court. It is said that in the case at bar, as in the *Marine Harbor* case, there is only one class of creditors; namely, the contract holders. In the case at bar there are many classes of contract holders. The contention that those instituting the Chapter X proceeding in the case at bar were seeking some benefits, as a similarity to the *Marine Harbor* case, is not supported by the record. It is said that the need for prompt liquidation was seen in the Fidelity case. We have previously commented that West

Virginia counsel in the hearing insisted that there could be reorganization in the State Court though not in the Federal Court. We are at a loss to see how counsel can assert that any need for prompt liquidation was seen.

In addition to the fact that in the *Marine Harbor* case resort had been had to a state reorganization proceeding where there are no state reorganization procedures other than ordinary equity receiverships available in the case at bar, the differences between the *Marine Harbor* case and the case at bar are so numerous and clear as to make impossible any logical comparison.

On page 41 of the West Virginia Brief it is stated that the Investment Company Act of 1940 was "definitely intended to cover Fidelity". A part of the Investment Company Act of 1940 is Section 25 which expressly preserved the jurisdiction of reorganization under Chapter X. Though the West Virginia Brief did not discuss the eligibility of Fidelity for reorganization, this assertion most certainly refutes any assertion in the other briefs of respondents that Fidelity is an insurance corporation ineligible for reorganization under Chapter X.

While Section 25 of the Investment Company Act of 1940 recognizes that there might be voluntary reorganization of investment companies and that some reorganizations might result from other judicial proceedings than Chapter X proceedings, we fail to find in said Section 25 of the Investment Company Act any manifestation of any congressional intent that the fact that the investment company might have deposits with some of the states should exclude such investment company from reorganization under Chapter X, the jurisdiction for which was expressly reserved and protected by Section 25.

It is argued on page 43 of the West Virginia Brief that the Congressional intent of Section 29 of the Investment

Company Act, amending Section 67 (f) of the Bankruptcy Act, was designed for application only to straight bankruptcy rather than to reorganization. Section 102 of Chapter X makes the provisions of the other chapters of the Bankruptcy Law applicable to Chapter X where not inconsistent therewith.

On page 57 of the West Virginia Brief it is said that officials of six states are respondents and have requested this Court that they be permitted to continue their prior state proceedings to liquidate Fidelity. This proceeding is to reorganize Fidelity. The State Court proceedings, certainly so far as originally instigated in West Virginia, were for the purpose of reorganizing Fidelity. It is not believed that the desire of the states to liquidate Fidelity in the State Court proceedings, originated for the purpose of there reorganizing Fidelity, should appeal very strongly to this Court when the change from the desire to reorganize to the desire to liquidate seems to have been prompted solely by the fact that the only court, the reorganization court, which can effectively reorganize Fidelity has taken jurisdiction of its assets.

On page 80 of the West Virginia Brief it is said that in the various states, after the claims of domestic creditors are satisfied, a surplus of assets remaining will be remitted to the domiciliary receivers. Petitioners have not doubted this principle of law but petitioners still insist that, if there is any reasonable prospect of any such surpluses being remitted, if the creditors in other states entitled to participate therein are to receive the benefit of any such surplus, their interests will have to be represented in such states in order to make certain that such states do not so administer and distribute such assets as to consume all of them.

The West Virginia Brief would make much of the assertion that the proposed administrations in the various

state courts are conducted by the Attorneys General of the several states. Although six states are actively participating as respondents in this cause, there is only one attorney general, the Attorney General from Wisconsin, actually actively participating. An examination of the record will show no active participation by the Attorney General of West Virginia beyond consent to the use of his name on briefs and pleadings.

On page 84 of the West Virginia Brief reference is made to the case of *Reading Hotel Corporation* v. *Protective Committee*, 89 F. (2d) 53, as sustaining the contention that liquidation should promptly ensue in the State Court proceeding. The *Reading Hotel Corporation* case was a case for reorganization in the Bankruptcy Court, and the reorganization was approved. The point in issue was the objection by the stockholders to their exclusion from participation in the reorganization plan.

On page 90 in the West Virginia Brief it is stated that on October 10, 1941, the Trustee prepared and submitted to the Court a partial report under Section 167, and on April 13, 1942, a further partial report,* and complaint is made that these reports have not been submitted in any form to the contract holders. It would hardly be expected that during the litigation relating to the basic jurisdiction of the reorganization court the expense of submitting any such reports to the creditors would be incurred or that the information thereof would be of any aid to the creditors. (See *Continental Illinois, etc., Co.* v. *C. R. I. & P. R. Co.*, 294 U. S. 648.)

On pages 91 to 96 of the West Virginia Brief the points of superiority of the Chapter X proceedings over equity

(*) This report is not in the record before this Court. It has been filed in the District Court and is an official paper in this cause. In view of counsels' reference to this report it is printed in the Appendix hereto. Therein the Trustee reports that reorganization beneficial to the creditors can be effected.

receiverships raised in Petitioners' Brief are discussed by West Virginia counsel. We shall not re-discuss all of these points but note that under Point (1) the West Virginia counsel refer to the efficiency of the reorganization under general equity proceedings in State Courts. Some of these reorganizations may not have complied with the standards of fairness which Chapter X prescribes.

Under Point (2) West Virginia counsel say that the petition was filed at the instance of the "old management group" of Fidelity. It matters not by what management group the petition was filed. There is no management group for conducting the proceeding under Chapter X. The Court, with the aid of the disinterested Trustee, conducts the reorganization proceeding under Chapter X.

When the Petitioners' Brief was prepared, counsel for petitioners were not then aware of the order of the Circuit Court of Kanwaha County of May 26, 1941, directing that the form and manner of submission by the State Receivers to the contract holders of any plan of reorganization and rehabilitation of Fidelity should be submitted to the court for approval before such submission. The fact that such order was entered by the Circuit Court of Kanawha County does not change the observation of Petitioners' Brief, however. Such order was not issued pursuant to any state statute requiring such procedure comparable to Sections 174 and 175 of Chapter X, and the order relates only to the submission of plans by the Receivers. It does not exclude the submission of plans by some management group or creditors' committee prior to approval by the court, and the court might at any time rescind this order, even as it applies to the Receivers.

As was anticipated in Petitioners' Brief, counsel for the respondents would attempt to meet the insufficiency of the ordinary equity receivership by saying that they will

cause to be done in the state courts voluntarily all that Chapter X requires by statute to be done.

With reference to Point (10) (W. Va., 94), Petitioners do not contend that Chapter X has made illegal voluntary reorganization without judicial aid or with the imperfect aid of courts operating without reorganization statutes. Petitioners do insist that the factual situation presented in the case at bar makes reorganization possible only through the Chapter X proceeding, and it is hardly consistent for the respondents to insist that there can be reorganization in the several state court proceedings while at the same time they insist that liquidation and distribution is inevitable and (W. Va., 57) are requesting this Court that they be permitted to continue their prior state proceedings to liquidate Fidelity.

Under Point (11) (W. Va., 95), West Virginia counsel say that those in charge of the state proceedings are state officials elected to their offices by the contract holders in the respective states. Nevertheless, the West Virginia State Auditor who instigated all of the State proceedings collaborated with representatives of Fidelity in endeavoring to hold assets of Fidelity in statu quo pending the accomplishment of voluntary reorganization, which, so far as the record shows, involved no plan other than one to sacrifice the interests of creditors in order to preserve some value for stockholders contrary to *Case* v. *Los Angeles Lumber Company, supra.*

The West Virginia Brief (W. Va., 96-100) and Appendix (W. Va., 116-125 and 130-134) contain references to and discussions of many matters and things which are not contained or referred to in any way in the record. Counsel for the petitioners are loathe to depart from the record, but these references demand some departure herein.

Counsel for the petitioners deny that the order of the Circuit Court of July 22, 1942 (268-270), contemplated liquidation of securities beyond such liquidation as was necessary for conservation. (See petition for modification and exhibits (271-285).)

At the informal hearing before Judge Parker upon the motion for the stay of the mandate to permit the filing of the petition to this Court for certiorari three of the counsel for respondents who represented themselves as a committee acting for all of the respondents' counsel complained of the delay in obtaining proofs of claims occasioned by the jurisdictional controversies and complained that under the order of the District Court the Trustee was not permitted to give to the various state officials the several lists of creditors by states. Judge Parker very correctly was of opinion that no harm would be done if proofs of claim were taken which might be utilized in the Federal Courts or in the several State Courts as the disposition of this case by this Court might make appropriate. Accordingly, paragraphs 5 and 6 of the order of July 22, 1942, were entered. Section 6, as well as Sections 1 and 3, was originally suggested to give the powers or rights to each state court having judicial supervision or control of cash or other securities deposited by Fidelity, but, upon the suggestion of one of the respondents' counsel that there were states in which there was no state court having jurisdiction but there were state officials having jurisdiction, there was added to these sections the phrase "or state official" having jurisdiction. The State Auditor of West Virginia has no statutory jurisdiction to give notice to contract holders or to accept proofs of claims. The Circuit Court of Kanawha County, West Virginia, declined to approve any forms of proofs of claims or to enter any order of any character in the West Virginia State Court proceeding un-

til the question of basic jurisdiction, now under consideration by this Court, should be determined. Counsel for the petitioners deny that the West Virginia State Auditor has any statutory authority to issue any such administrative order as is referred to at the bottom of page 133 of the West Virginia Brief in connection with the forms of proofs of claims. Counsel for the petitioners hope that these proofs of claims, not for liquidation and distribution of assets but for the determination of the interests of the several creditors, may be usable in the District Court for purposes of reorganization; or that, if this Honorable Court should be of opinion that jurisdiction under Chapter X has not been sustained, that such proofs of claims might be usable in the State Courts. Counsel for the petitioners deny that such proofs of claims have been sent out by the Auditor of West Virginia in keeping with the order of the Circuit Court of July 22, 1942, for the reason that said order contemplated the submission of such proofs of claims only through action of the State Courts in states in which there were State Court proceedings and not by administrative officials invested with no powers to adjudicate claims in states in which there were such State Court proceedings.

Counsel for the petitioners are not advised of the various activities engaged in by representatives of the several states as discussed in the several paragraphs in the Appendix to the West Virginia Brief dealing with the "digest of depository laws and trust indentures of the fifteen states where Fidelity made a deposit and status of state court proceedings pending therein" (W. Va., 116-125).

West Virginia counsel say (W. Va., 99) that no objection to the procedure of taking proofs of claims has been made by any contract holder. Naturally, no contract holder has complained because the letter by which said proofs of claims were sent out, as well as said proofs

of claims (W. Va., 130), show, in keeping with the understanding had from Judge Parker, that "should it finally be held that the Federal Court has sole jurisdiction of the proceedings all proofs of claim received will be turned over to the proper officials thereof."

Said proofs of claims are prepared for filing with "H. Isaiah Smith and Ross B. Thomas, West Virginia State Court Receivers, as such, and *as agents of Edgar B. Sims,' Auditor and Ex Officio Insurance Commissioner* • • • ." (W. Va., 131.) Whether or not H. Isaiah Smith and Ross B. Thomas have undertaken to act as agents of Edgar B. Sims, Auditor, counsel for the petitioners do not know, but counsel for the petitioners do know that said Smith and Thomas, West Virginia State Court Receivers, are not agents of Edgar B. Sims, Auditor, etc., by virtue of their appointment as receivers. In the hearing in the District Court H. Isaih Smith testified that he regarded himself as an arm of the Circuit Court of Kanawha County (822; Rep. Tr. 2356).

The Wisconsin Brief

On page 40 of the Wisconsin brief, it is said that Mr. Fleming, the Debtor's attorney who presented the petition, "withdrew during the course of the trial and was replaced by Mr. John Ray on September 17, 1941." Page 662 of the Record is referred to as the authority for this observation. Counsel for the petitioners see nothing whatever on page 662 which would even lend color to such statement, and say that there is nothing in or outside of the record substantiating this statement. It is true that Mr. Fleming was taken ill during the hearing, and that Mr. Ray was engaged principally for that reason. It is also true that Mr. Fleming has not participated actively in court proceedings since that time. Mr. Fleming is, however, yet counsel for the Debtor, and after the de-

cision of the Circuit Court of Appeals, but prior to the presentation of the petition for rehearing therein, Mr. Holt was also engaged on behalf of the Debtor. The order of the District Court approving the employment of Mr. Ray and the order of the Circuit Court approving the employment of Mr. Holt are printed herewith in the Appendix. Mr. Fleming has conferred with other counsel for the Debtor as late as the day upon which petitioners' brief was filed herein, and even thereafter has conferred with counsel representing the S. E. C. On page 140 of the Wisconsin brief, observations, wholly without record support, are made which would at least carry implications imputing doubt with respect to the employment of Messrs. Ray and Holt. These implications may be discussed in argument.

On page 41, it is said that the State Auditor renewed Fidelity's license as an insurance company on April 1, 1941, to expire March 31, 1942. The affidavit of F. J. McNulty (231-232) shows that Fidelity applied for such license and sent its check to the State Auditor for that purpose, but that the application was returned by the Auditor, the check was not cashed but was returned by the Auditor, and said license was not issued. This is further confirmed by the stipulation of counsel made in the Circuit Court (237).

On page 45, it is stated that licenses were issued to twenty salesmen of Fidelity as life insurance salesmen. The statement of the State Auditor (462) refutes this statement, as does the testimony of A. L. King (701).

On page 46, it is said that Fidelity, in fact, issued life insurance policies and assumed insurance risks. The only record basis for any such statement is that provided by the references to the riders to be attached to the Series B contracts containing the insurance features made in the

petition to the Circuit Court for remand (219), and in the stipulations of counsel entered into in the Circuit Court (237). Even if for purposes of argument it be assumed that such riders constituted the assumption of life insurance risks, which counsel for the petitioners do not admit, there is no evidence whatever that Fidelity issued life insurance policies.

Though the letter to the Banking Commissioner of Wisconsin, of December 21, 1940, stated by way of recital that the proposed amendments to the Fidelity charter would enable Fidelity to write insurance contracts, there is no statement that Fidelity had otherwise qualified, and no effort was made to qualify Fidelity as an insurance company in Wisconsin.

Counsel invite particular attention to the concession on page 64 of the Wisconsin brief that Fidelity was not an insurance company prior to December 31, 1940. This concession if acceded to by all respondents greatly simplifies the question of Fidelity's eligibility for reorganization, and makes that question rest solely upon the effectiveness of the attempted transformation on and after December 31, 1940.

In this connection, on page 96 of the Wisconsin brief, it is conceded that Fidelity could not change its classification for the purpose of avoiding an involuntary petition. Following the philosophy of the *Marine Harbor* case, petitioners' counsel most earnestly insist that the unsuccessful efforts of Fidelity to transform itself into an insurance company do not estop it from filing a voluntary petition.

The references in the Wisconsin brief to Fidelity's "unconditional license" as an insurance company are astounding (Wis., 67 and 69). Even the Wisconsin brief (Wis., 65) states that such license "was issued pursuant to an informal understanding with the Insurance Com-

missioner that it would enter into no new contracts of any kind until he had advised the company that it might do so", and that the West Virginia Auditor had testified that he had issued the license "in order that the Debtor would have authority to receive payments under its outstanding contracts." The record is clear and undisputed that this so-called license was but a sham. (See Record References, page 9, Petitioners' Brief.) In this same connection, it is interesting to observe that in the West Virginia brief (W. Va. 33) it is argued that Fidelity could never comply with the Investment Company Act of 1940, because the company was required to have a clear capital of $50,000 in order to so qualify. It is also true that in order to qualify as an insurance company in West Virginia, and to become entitled to have a license as an insurance company from the State Auditor under Section 1, Article 3, Chapter 33 of the West Virginia Code (Petitioners' Brief, Appendix, 69), it was necessary that Fidelity have "at least $200,000 cash capital fully paid up or a like amount of cash surplus * * *." This requirement, undoubtedly, made the actual qualification by Fidelity as an insurance company at the time impossible. It may seriously be questioned whether, even had the State Auditor issued Fidelity a license as an insurance company without qualification, Fidelity would in reality have been a licensed insurance company. The Auditor had no power or authority to issue any such license unless Fidelity was so qualified, and Fidelity knew of these requirements as well as did the Auditor.

On page 68, it is argued that it cannot be questioned that the so-called riders relating to the Series B contracts constituted insurance contracts. In the absence of the development of a more complete record with respect to these riders, petitioners' counsel need not express an opinion as to whether or not the form and substance of these riders were such as to occasion the as-

sumption of some character of insurance responsibility if such riders were legally issued. On the other hand, it may seriously be questioned whether public policy permits the giving of validity to purported insurance undertakings by a company not in fact licensed. Furthermore, for purposes of reorganization, the determination of the rights and interests of creditors, even though some technical legal obligation may have been incurred, it is very doubtful whether such undertakings amounted to engaging in the insurance business in any practical sense, in view of the fact that the existing plan of carrying the insurance with the Lincoln National Life Insurance Company was not in any manner changed.

The Wisconsin brief concedes the power of Congress to provide that corporations now ineligible for bankruptcy be eligible therefor (Wis., 77). The brief also concedes that face-amount certificate companies are amenable to bankruptcy, and that it was not necessary for the Bankruptcy Act to make them so amenable (Wis., 88). The brief (Wis., 85-89) also recognizes that the definitions of investment companies as provided by the Investment Company Act of 1940 would include all life insurance companies were it not for the express exception of life insurance companies from said definitions made by the Investment Company Act, Section 3(c) (3) and Section 2(a) (17). The brief also concedes that, had face-amount certificate companies been excluded from bankruptcy prior to the enactment of the Investment Company Act, then said Act would have made such face-amount certificate companies amenable to bankruptcy (Wis., 89). The inescapable conclusion from these concessions is, therefore, that even if Fidelity prior to the enactment of the Investment Company Act of 1940 might have been classified as an insurance company rather than as an investment company, Fidelity is, nevertheless, an investment company, a face-amount certificate com-

pany of the installment type, unless it comes within the exclusionary definition of an insurance company as provided by the Investment Company Act, Section 2(a) (17). It is obvious that the activities of Fidelity Assurance Association, even after the charter amendment of December 31, 1940, and even if it be conceded for purposes of argument that Fidelity's license as an insurance company was valid and unconditional, do not bring Fidelity within the definition of an insurance company as provided by the Investment Company Act.

Despite the foregoing concessions and the inescapable conclusion, the Wisconsin brief would argue that there was no congressional intent on the part of Congress that the definitions of investment companies and insurance companies, as found in the Investment Company Act of 1940, should have any bearing on the previously established judicial definitions of an insurance company for purposes of bankruptcy within the meaning of Section 4 of the Bankruptcy Act. In view of the express amendments to the bankruptcy law made by Section 29 of the Investment Company Act, and the express reservations of powers of courts of the United States with reference to reorganizations as contained in the Bankruptcy Act of 1898, as amended, made by Section 25 (d) of the Investment Company Act, this contention is plainly unsound, indefensible and untenable.

The Wisconsin brief (Wis., 92) correctly says that Fidelity procured the charter amendment as an insurance company in an effort to avoid the Investment Company Act. Had Fidelity become in fact an insurance company, it would have avoided the Investment Company Act. If then Fidelity did become an insurance company as the respondents insist, why did it not immediately resume its annuity contract business as it had formerly been conducted, since no one denies that life insurance

companies in many states may issue annuity contracts! Neither the $50,000 capital requirement nor the 7% loading charge provisions of the Investment Company Act would have been applicable to Fidelity as an insurance company, excluded from the provisions of the Investment Company Act, and these were the provisions of the Investment Company Act which it is said made it impossible for Fidelity to operate thereunder.

The Wisconsin brief (Wis., 84) concedes that if a corporation engages in more than one activity, each of which is within its charter powers, it is proper that the court look to the business actually done in determining the character of the corporation.. This is a flat concession by Wisconsin counsel of the correctness of petitioners' position.. Two charter powers of Fidelity were involved, one the issuance of annuity contracts, which power Fidelity not only had but exercised for many years and retained under the charter amendment of December 31, 1940; the other, the power to issue contracts of insurance, which was not had even formally prior to December 31, 1940, and which was not had in fact even thereafter, and which was not exercised. Admitting for purposes of argument, that Fidelity had both of these powers after December 31, 1940, by counsels' own concession it is necessary and proper that the Court look to the business activities in order to determine the proper classification.

The Wisconsin brief (Wis., 109) suggests that if an orderly liquidation of the Debtor's assets is to be considered reorganization, such must be limited to cases where the debtor can make some showing of "going concern value." Fidelity has a large number of customers, it has a well selected portfolio of investments, it has good will (632), and the respondents even after the decision in the Circuit Court by their activities have recognized

the value of the assets of Fidelity as a whole as distinguished from the value which they would have if they were liquidated by lots or parcels through independent activities and without concerted management (281, 282; W. Va., 97; Md., 68, note 11).

The Wisconsin brief (Wis., 113) says that the cases *In re Porto Rican American Tobacco Company*, 112 F. (2d) 655, and *Continental Insurance Company* v. *Louisiana Oil Refining Corporation*, 89 F. (2d) 333, and other cases cited in petitioners' brief (Page 42), are not helpful on the issue of good faith. The respondents argue that good faith is lacking because there cannot be complete rehabilitation. These cases show that complete rehabilitation is not the only legal method of reorganization. If it be assumed, which petitioners' counsel deny to be the fact, that there could be no rehabilitation, but these other methods of reorganization are available, most certainly the existence of such other methods of reorganization strongly support the probability of reorganization and tend to rebut the contention of the respondents that there was want of good faith because there was no probability of reorganization.

On page 121 of the Wisconsin brief, it is insisted that it is unreasonable to expect that there can be reorganization because the field offices of Fidelity have been closed and its sales force has been completely dissipated. It must be remembered that the purpose of reorganization of an insolvent company is not to maintain the organization of such company unless it be required for the best interests of the creditors, but is to protect and promote the interests of the creditors however that may be done.

The statement of the Wisconsin brief that no witness was able to give a hint as to the manner in which reorganization could be effected (Wis., 122-125) is incorrect. The West Virginia State Auditor suggested

the organization of a mutual company. The witness D. A. Burt thought that upon a proper set-up new capital might be available. The witness Hubert F. Young suggested the possibilities of merger with another company or organization as a mutual company, the activities of which might include both annuities and insurance. The witness Latta referred to the possibilities of deferred orderly liquidation. (See Record References, pages 44 and 45, Petitioners' Brief.)

On Page 126 of the Wisconsin brief it is stated that if Fidelity was not an insurance company on the day the petition was filed "it seems obvious that it could not reorganize itself as such under Chapter X." Petitioners' counsel know of no provision of Chapter X or of any other principle which would prevent the reorganization court in a Chapter X proceeding from approving a plan of reorganization which would result in the reorganized company's becoming an insurance company. That insurance companies are not eligible for reorganization certainly does not argue that a company eligible for reorganization may not be reorganized into an insurance company.

That some courts have criticized the methods by which Fidelity previously operated, as stated in the Wisconsin brief (Wis., 129), certainly does not mean that the former methods of Fidelity which were criticized must be embodied in the plan of reorganization. The court and the independent trustee, with the assistance of the Securities and Exchange Commission, formulate the plan of reorganization, not the debtor.

On page 131 of the Wisconsin brief, it is argued that the state authorities would not likely permit the operation of the Fidelity plan in their several states hereafter. Yet, in endeavoring to show that Fidelity was a life insurance company because life insurance companies may issue an-

nuity contracts, the respondents do not question the fact that sound and legal annuity contracts can be made and executed.

On Page 139 of the Wisconsin brief, it is charged that the Trustee is not disinterested because the Trustee has been active in assisting in the defense of the basic jurisdiction of the District Court and is one of the petitioners in this Court. That the trustee must be disinterested refers to its business and financial interests at the time of the trustee's appointment and during the course of the proceeding. Most certainly the qualification of disinterestedness does not mean that the trustee must be indifferent towards a proceeding which the trustee believes to be for the best interests of the creditors whose rights and interests the trustee has been appointed to preserve and protect. The mere fact that the trustee may expect to receive, and may receive, reasonable compensation for its services, certainly does not take the trustee out of the classification of disinterested persons.

The Maryland Brief

The Maryland Brief (Md., 14) says that the statement in Petitioners' Brief (Petitioners' Brief, 6) with respect to the creation of a reserve fund for the particular class or series of contracts from payments made on contracts of that particular class or series is incorrect. Counsel for the petitioners have taken said statement almost verbatim from the findings of the District Court (180). It is believed that the statement is fully sustained by the record. Be that as it may, the Maryland Brief (Md., 14) concedes that such particular reserve funds were to be kept separate and solely for the discharge of liabilities under contracts of Series B and D and, even if it be granted for purposes of argument that the contract provisions of other series were not quite so explicit, the legal results

with respect to Series B and D cannot be ignored. The reserve funds of Series B and D represent a very substantial part of Fidelity's assets. The Maryland Brief (Md., 65 and 66) suggests that the state laws do not expressly require segregation by series funds and would imply that the state laws exclude the creation or recognition of more than one fund. Petitioners' counsel do not believe that any statute involved can be reasonably argued to make improper the segregation of the deposits by contract series if the contracts so contemplate or provide.

The Maryland Brief (Md., 9) says that the contention of the petitioners and the Securities and Exchange Commission that on its books Fidelity kept accurate and separate accounts for the reserve funds of each series of contracts issued by it and that the books indicated what securities were purchased with the reserve funds of each series is misleading. Counsel have heretofore presented some of the many statements in the record demonstrating the accuracy of the statement that on the books of Fidelity the funds and investments were kept separate. Of course the actual bonds were not despoiled by writing upon the face of the securities the funds to which they belonged. That is not the customary way for the identification of securities. The Maryland Brief (Md., 9) does concede that during the latter years and after the entry of the injunction order in December, 1938, Fidelity made efforts to segregate its state deposits by series. Even if it be admitted for purposes of argument that Fidelity's segregation of funds was not perfect, that fact should not make it unnecessary that the segregation in so far as perfect should be recognized in this proceeding.

In the Maryland Brief (Md., 13) it is stated that the petitioners erred in saying that the reserve funds of contract Series A, B, C, and D are solvent. Maryland counsel may not be bound thereby but the authority for this

statement by petitioners' counsel is the statement of the respondent West Virginia Auditor as contained in his telegram to the Banking Commission of Wisconsin (1215, 311), a telegram similar to which was sent to some sixteen states on the 11th day of April, 1941, the day on which the West Virginia State Court proceeding was instituted.

Counsel for the petitioners recognize that there may be many different modes or bases by which the solvency or insolvency, and the degree of insolvency, of Fidelity may be computed. Counsel for the petitioners adopted the basis recognized generally during the hearing of this cause. Various computations and adjustments are made in tables presented in the West Virginia Brief, and the Maryland Brief insists that Fidelity is less than 90% solvent. The basis adopted by the Circuit Court of Appeals and used by counsel for the petitioners may be said to be as typically illustrative as any other basis that might have been selected. Upon any basis, from the common knowledge of the general appreciation of securities for the past two years, it may safely be assumed that the securities of Fidelity have materially increased in value between the dates as of which the various figures in the record were taken and the present time.

CONCLUSION

In the foregoing argument counsel for the petitioners have not undertaken to reply in detail to all of the arguments and contentions in the several briefs of the respondents. Counsel have not even mentioned some of the arguments and many of the errors and inconsistencies thereof. Counsel have endeavored to correct some errors in statement, some errors in interpretation of cases, and to demonstrate the fallacies of the principal arguments in the several briefs of the respondents.

The fact that there are three briefs on behalf of the respondents has made it impracticable for counsel to present their reply argument in a manner as orderly and well arranged as counsel would otherwise have desired.

It is believed that this Reply Brief has demonstrated the unsoundness or the inapplicability of the principles relied upon by the respondents, and it is again urged that the order of the United States Circuit Court of Appeals for the Fourth Circuit should be reversed and that the order of the United States District Court for the Southern District of West Virginia should be affirmed.

Respectfully submitted,

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Charleston, West Virginia,
February 6, 1943.

APPENDIX

Part II of Trustee's Report, April 13, 1942*

In the Matter of) In Proceedings for
FIDELITY ASSURANCE) Corporate Reorganization.
ASSOCIATION, *Debtor.*) No. 4514.

REPORT OF CENTRAL TRUST COMPANY, TRUSTEE, AS PROVIDED BY ORDER OF FEBRUARY 25, 1942, DESIGNATED AS "PART II" OF TRUSTEE'S REPORT UNDER SECTION 167, CHAPTER X.

To the Honorable Ben Moore, Judge of the District Court of the United States for the Southern District of West Virginia.

The Central Trust Company, Trustee, respectfully reports to the Court as follows:

The Court's attention is directed to the report of the Trustee filed herein on October 6, 1941, (designated as Part One) which was filed pursuant to the requirements of Section 167, of Chapter X, which contained, among other things, information concerning the following:

A. Nature and history of the debtor's business.

B. Statement of assets and liabilities of the Company as of June 6, 1941, broken down as to the several contract funds.

*This report is not a part of the Record. It is referred to at Page 90 in the West Virginia brief. For that reason it is presented herewith.

C. Schedules showing the location and value of the Company's assets. Also schedule showing assets on deposit in the various states and the liabilities to contract holders by states.

D. Schedules showing rating by classification of securities owned by the Company.

E. Various tables, charts, and brief statements concerning numerous other matters such as tenure of office of officers and directors, the method employed in making investments, detailed information concerning investment securities sold by the Company, and a list of other items on which the Trustee would report after a detailed examination and audit.

The Court's attention is also directed to the report filed herein by the Trustee on August 5, 1941, which contained, among other things, the following:

A. A list of securities delivered to the Trustee.

B. A list of the holders of the common stock of the debtor.

C. A list of the holders of the preferred stock of the debtor.

D. A list of the contract holders which contains the following information:

(a) Contract number.

(b) Name and last known address of the contract holder.

(c) Actuarial reserve. (This figure supports the reserve as shown on the balance sheets.)

(d) Cash liabilities.

(e) Loans to contract holders.

(f) Additional credits. (This applies only to Series "B" contract holders.)

E. Balance sheets showing the assets and liabilities of the debtor as of June 6, 1941.

F. A schedule showing the par value, book value, and market value by funds of all securities owned by the debtor as of June 6, 1941.

Although your Trustee has refrained from incurring the expense of an audit which will be necessary before a full and complete report can be made on the items set forth on Page 64 of the Part One Report, your Trustee submits the following as a continued partial report under Section 167 of Chapter X.

1. Your Trustee is of the opinion that during this proceeding it is desirable to continue the operation of the debtor's business to the extent and in the manner followed by the Trustee since the commencement of the proceeding; i. e., servicing the securities in the possession of the Trustee, servicing the portfolio, with recommendations, as they appear proper, to the state custodians of assets; the conservation of the estate in the manner and according to the established rules for managing trust estates; maintaining and operating the home office to the extent necessary for preserving and caring for the records of the company with the view of having such office and records readily available to any plan of reorganization that may be effected; collecting the payments made by contract holders under the order of June 14, and maintaining the escrow accounts therefor; making refunds, upon receipt of proper applications, to contract holders of payments made by them since June 6, 1941.

2. The method adopted and followed by your Trustee for servicing the investment portfolio of the debtor is described in considerable detail, with examples, in the Trustee's application for interim allowances filed herein on March 10, 1942. Briefly, the method is as follows: In collaboration with the firm of Standard and Poor's Corporation, nationally recognized authority on statistical analysis, forms were designed and prepared for statistical reports on each security in the portfolio. In the beginning the said Standard and Poor's prepared an analysis of each security in the portfolio and these analyses are kept up to date by a revision of the analysis each time the issuing company releases a statement. Copies of the analyses are furnished to your Trustee and to Hubert F. Young, former investment officer of the debtor, now employed by the Trustee, who in turn presents to the Trustee his report and opinion concerning the security, based upon the said Standard & Poor's report and upon such other information as the said Young gathers at his New York office. With the reports of the said Standard and Poor's and the said Young before it, your Trustee then decides, through its investment committee consisting of Messrs. Dickinson, Picklesimer and Payne, whether the security in question should be held, sold, exchanged or converted, or whether any other action should be taken with respect thereto such as giving consent or filing objection to plans of corporate reorganizations, etc. Immediately after reaching a decision the Trustee notifies all state depositories holding said security in question of its decision and recommendation.

After making this detailed analyses of the securities portfolio the Trustee is of the opinion that the best interest of the contract holders and other parties in interest can be best served through some form of reorganization or by slow and orderly liquidation.

The estate of the debtor may be divided generally into four classes of property:

(1) Securities having a ready market value and convertible into cash immediately,

(2) Securities for which there is only a limited market, but which can be sold without great difficulty or delay,

(3) Securities which can be sold only in small blocks and which must be sold with considerable caution in order to prevent depressing the market therefor,

(4) Real estate.

The analyses by your Trustee of the securities contained in the portfolio disclose that only approximately fifteen per cent of the securities can be classified as having a ready market. This does not necessarily mean that there is no market for the remaining securities, but as a group they would require careful handling, and if sold should be offered in small blocks on a favorable market in order to prevent a depression of the market with consequent loss in prices realized. A study is being made of the real estate owned by the debtor, and recommendations regarding the same will be made as soon as such study is completed.

Your Trustee feels that in view of the character of the investments in the securities portfolio that any procedure requiring rapid liquidation such as would be required in straight bankruptcy would tend to dissipate the assets of the Company, thereby causing needless loss to the creditors.

3. Your Trustee at this time is unable to present any details of a plan of reorganization due to the fact that there are certain important matters that must be decided

upon from a legal standpoint before a plan can be worked out and submitted. Your Trustee reports, however, that there has been several suggestions made as to the kind of business into which the Company may be reorganized into a going concern. Some of these suggestions were made during the hearing before Your Honor beginning August 5, 1941 and concluded October 10, 1941, together with additional suggestions made to your Trustee. Among the suggestions are, (a) insurance company, (b) investment trust company, (c) mutual savings and loan company, (d) face amount certificate company with insurance provisions.

Your Trustee reports as one possibility that will lend itself for consideration for reorganization is that the assets could be placed in a management trust. This, your Trustee believes, would be profitable to the general interest, irrespective of the interest of the individual beneficiaries (present contract holders) as the same may be ultimately determined. Such a trust could be managed in a way so as to dispose of securities in an orderly manner with the income in the form of dividends and interest derived from the securities accruing to the benefit of the creditors. A feature could be incorporated in the trust whereby beneficiaries (the present contract holders) could borrow a designated percentage of the amount of their equities which could be adjusted from time to time as changing conditions would warrant. This would give some relief to contract holders who are in immediate need of cash, and at the same time provide a means of keeping surplus cash invested. The present securities portfolio has a number of securities that have a high interest yield with safety of the principal being somewhat questionable. In such instances certainly a management trust would be beneficial to the creditors as by careful management these securities could be gradu-

ally sold and the proceeds reinvested in other securities of a type conforming to the kind usually purchased and owned by trust estates.

4. Your Trustee is not able to report in detail as to alleged irregular practices of the former management which may render those participating therein liable to debtor in damages. Counsel for the Trustee is now engaged in making a detailed study of this question.

5. Before the rights and priorities of contract holders can be determined, and before the details of a plan of reorganization can be perfected, it will be necessary, among other things, to have questions such as the following adjudicated by the Court:

While the Company was operating, loans were made from one contract series fund to another. This created a situation of setting up on the Company's books debtor and creditor funds. Will these loans between contract funds be considered as a prior claim on the assets of the particular debtor fund? Or, will they be considered as sharing on the same basis as other creditors? Or, will they be considered as common creditors and repaid only after all other creditors are paid? The decision on these important questions will be far reaching in its effect upon the contract holders in the funds involved.

A very complicated situation exists in the matter of the Company's deposits with the various states. The clearest presentation of this condition can be achieved through a combination of the following explanation and illustrations:

As pointed out in the Part One Report, there is no uniformity in the statutory requirements of the various states with regard to requiring deposit of securities to be held by designated state agencies to insure the liabilities

to contract holders in each particular state, or as prerequisites for qualifying to do business in the states.

As was also pointed out in Part One of this report, the Company has outstanding six series of contracts: (1) Special Income; (2) Special Annuity; (3) Income Reserve (Usually referred to as Series "A"); (4) Series "B"; (5) Series "C"; and (6) Series "D".

The Company maintained separate records for each of the six series. Money collected from the contract holders of any one particular series was used to purchase securities as investments specifically intended for that series fund, and were so recorded on the books of the Company. Your Trustee has found, however, that in many instances situations like the following occurred:

An increase occurred in the liability to Series "B" contract holders in State "X". For one reason or another, acceptable securities which had been purchased for that fund were not immediately available. The Company thereupon deposited securities purchased for the Series "A" fund because they were on hand at the time. It is important to remember that the securities deposited were purchased with money collected from Series "A" contract holders *everywhere* and not solely with money collected from contract holders in State "X". This is but an example of similar occurrences which have involved all series of contracts in one manner or another, with the possible exception of Series "C".

Summing up, the following involved condition exists:

Certain securities purchased with money collected from the contract holders of one or another series *everywhere* have found their way into the hands of one or another particular state; and frequently to cover the liability in an entirely different series.

The questions growing out of this situation are:

1. Shall the assets, owned by the Company, be considered as securing the contract liabilities of all contract holders alike without regard to the series of contracts owned and also without regard to the fact that the assets were deposited in the various states?

2. Or, shall the assets, as carried on the books of the Company by contract series, be considered as securing the contract liabilities to *all* contract holders of that series *everywhere*, without regard to the fact that the assets have been deposited in the various states?

3. Or, shall the assets on deposit in any particular state be considered as securing the contract liabilities of *only the contract holders of that state?* And, if so:

(a) Shall the assets be regarded as covering the over-all liability to contract holders in that state, regardless of contract series?

(b) Or, shall the separate assets be regarded as belonging only to the contract holders of the series for which the assets were *deposited?*

(c) Or, shall the separate assets be regarded as belonging only to the contract holders of the series for which the assets were *purchased?*

(d) The Statute of the State of West Virginia requires, as a prerequisite for securing a license to do business, a deposit of $100,000.00 plus additional deposits equal to 100% of the Company's contract liability everywhere (due allowance being made for deposits in other states). How shall the securities deposited with the Treasurer of West Virginia be administered? Will they first be looked upon as securing, in full, the liabilities to West Virginia contract holders? Or, will the West Virginia contract holders share on the same basis

as contract holders in other states? In either event, how will the excess over the liabilities to West Virginia contract holders be administered? This question can be of far reaching importance as, on the basis of present market values, the securities on deposit with the Treasurer of West Virginia exceed by approximately $8,000,000 the liabilities to West Virginia contract holders. What will be the equitable basis in using any part of this excess, for example, to secure claims of contract holders in states where the market value of securities may be only 50%, 35%, 28%, 16% and 10% of the liabilities?

(e) In which state shall the liability to the contract holder be established in a situation like the following: The contract holder purchased the contract in a state which required a deposit of securities equalling 100% of the liability in the state, and at a later date moved either to a state which required a lesser deposit in proportion to liabilities there or to a state requiring no deposit, or a fixed deposit without regard to liabilities.

To summarize this statement your Trustee again refers to the Part One Report which pointed out that the business presents many complex problems, and we have attempted to present some of them. Your Trustee believes that as soon as possible, following the decision of the appeal now pending in the United States Circuit Court of Appeals, a decision should be had on the status of the separate funds and the priorities, if any, of the holders of contracts in each fund. Your Trustee is of the opinion that it can best be done in connection with and as a part of whatever claim procedure is decided upon.

Taking into consideration all facts and circumstances relating to debtor's property and financial conditions,

your Trustee is of the opinion that a reorganization, within the objects of Chapter X, can be worked out which will be of benefit to the contract holders.

Respectfully submitted,

CENTRAL TRUST COMPANY,

Trustee.

April 13, 1942.

Order of District Court Approving Engagement of John V. Ray as Counsel to Aid Other Counsel of Fidelity

(At a District Court of the United States for the Southern District of West Virginia, at Charleston, in said District, on August 25, 1942)

In the Matter of	)	No. 4514
FIDELITY ASSURANCE	)	In Proceedings
ASSOCIATION,	)	for Corporate
Debtor.	)	Reorganization

This day came Fidelity Assurance Association, Debtor, by its attorney James R. Fleming and presented its petition for authorization to engage John V. Ray of Charleston, West Virginia, as additional counsel to aid and assist other counsel for Fidelity Assurance Association, Debtor, in the proceedings for corporate reorganization pending herein; and said petition is ordered filed.

And the prayer of said petition being proper, the same is granted and approved and Fidelity Assurance Association, Debtor, is hereby authorized to engage John V. Ray of Charleston, West Virginia, as counsel to aid and assist other counsel of Fidelity Assurance Association, Debtor, in the proceedings for corporate reorganization filed herein.

This order, having been inadvertently omitted from entry on the 3rd day of September, 1941, is entered now for then, and shall be effective as of September 3rd, 1941.

Enter:

(Signed) Ben Moore
U. S. District Judge.

A true copy from the record,
Attest:

(Signed) Earl R. Cavender, Clerk
(SEAL) D. C. U. S., S. D. W. Va.

Order of Circuit Court Approving Engagement of Homer A. Holt as Additional Counsel to Aid Other Counsel of Fidelity

IN THE UNITED STATES CIRCUIT COURT OF APPEALS

FOURTH CIRCUIT

No. 4923

EDGAR B. SIMS, Auditor of the State of West Virginia, and, Ex Officio Insurance Commissioner of the State of West Virginia, et al.,

Appellants,

vs.

FIDELITY ASSURANCE ASSOCIATION, a corporation, Debtor,

Appellee.

This day came Fidelity Assurance Association, Debtor, by its attorney James R. Fleming and presented its petition for authorization to engage Homer A. Holt of Charleston, West Virginia, as additional counsel to aid and assist other counsel for Fidelity Assurance Association, namely, the said James R. Fleming and John V. Ray, in the preparation and presentation of a petition for rehearing in the United States Circuit Court of Appeals, Fourth Circuit and, in the event said petition be denied, in the preparation and presentation of a petition in the Supreme Court of the United States for a writ of certiorari to the United States Circuit Court of Appeals, Fourth Circuit, and to aid said counsel in the preparation and presentation of the case in the Supreme Court of the United States in the event said petition for certio-

rari be presented and granted; and said petition is hereby ordered filed.

And the prayer of said petition being proper, the same is granted and approved and Fidelity Assurance Association, Debtor, is hereby authorized to engage Homer A. Holt of Charleston, West Virginia, as counsel to aid and assist the other counsel of Fidelity Assurance Association, Debtor, in the preparation and presentation of the petitions as aforesaid and in the preparation and presentation of this case before the Supreme Court of the United States in the event such petition for certiorari to the United States Circuit Court of Appeals, Fourth Circuit, be presented and granted.

This order, not having been presented on the 10th day of July, 1942, and Homer A. Holt having rendered services from that date, it is entered now for then and shall be effective as of July 10, 1942.

(Signed) John J. Parker
Senior Circuit Judge.

Endorsed
"FILED
Aug 15 1942
Claude M. Dean
Clerk"

A true copy
Teste:

(Signed) Claude M. Dean Clerk,
U. S. Circuit Court of
Appeals, Fourth Circuit

(SEAL)